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SUBJECT: GROWING OPTIMISM ON CLIMATE AND ENERGY PACKAGE

¶1. The horse-trading is moving at a furious pace in Brussels as efforts to finalize the EU,s Climate and Energy package appear to be yielding fruit. The French, in their capacity as Council President, have been holding meetings of representatives from member states (COREPER) and between Commission, Council and Parliament officials (trilogue) on a daily basis. (Notably, the Environment Council cancelled today,s session and did not issue any conclusions on the package.) The meetings have been stretching to one and two o,clock in the morning in an effort to iron out the details on issues including auto emissions, carbon capture and storage (CCS) and biofuels. One Commission official said that most of the contentious issues have been addressed, but lamented that package has become watered-down. The major remaining obstacle appears to be Italy,s opposition to the renewables legislation, but there is a growing consensus that a political agreement will be reached during the 11-12 December European Council meeting, if not sooner. French President Sarkozy will also travel to Gdansk, Poland on 6 December to address concerns of eastern bloc countries.

Auto Emissions

¶2. One of the key agreements reached this week was on auto emissions. Under the terms, auto makers will have until 2015) three years more than originally proposed) to limit average emissions to 130 grams of carbon dioxide per kilometer, down from the current average of 158 grams. There will be a phase-in period, beginning in 2012 when 65%of new vehicles must meet the emissions cap, 75% by 2013 and 80% by 2014. Auto makers that fail to reach these goals will be fined five Euros for each extra gram of CO2 per car and 95 Euros per gram if they miss the limit by four grams. Beginning in 2019, the penalty for each extra gram will cost 95 Euros per car.

Emissions Trading Credits

¶3. The Emissions Trading Scheme (ETS) directive of the package extends the EU,s CO2 cap and trade system into its third phase, beginning in January 2013 and running to 2020. The scheme, which sets forth the emissions limits for certain sectors, has come under much criticism from eastern member states, particularly Poland, which is dependent upon coal for over 90% of its power supply. Under a proposal put forth by the French, emissions permits would be issued to member states with half of the EU,s average per capita income or less and which rely on coal for more than 30% of their electricity. The allocations would commence in 2013 and would be phased out over a three to or-year period, after which all permits would ave to be purchased at auction. The goal of this proposal is to afford the Polish and other coal-based and/or less-affluent economies more time to convert their power sectors. President Sarkozy will meet with leaders from Polan, the Czech Republic, Bulgaria, Estonia, Hungary, Latvia, Lithuania, Slovakia and Romania in Gdansk on 6 December to discuss the proposal an secure their support for the package. If the proposal s adopted, Cyprus and Malta could also benefit.

Aviation Emissions
¶4. Under a directive issued this summer, aviation was included in the overall ETS from 2012 and subject to the changes in the general review for the next phase 2013-2020. For the initial one year period 2012-2013, the level of auctioned permits --as opposed to those distributed for free -- was set at 15 percent. According to contacts at DG Transport and DG Environment, it remains an open question as how the amendments to the general emissions will impact the aviation sector, but latest indications are that specific provisions will be left unchanged. It is possible, however, the final decision could increase the auction level to 20 percent as Parliament has suggested or could even bring the aviation sector more closely in line with general ETS requirements.
Carbon Capture and Storage
¶5. Funding for CCS pilot projects has been a contentious issue between the Parliament and the Council. Parliament has sought to finance the projects by providing them with 500 million carbon credits from the ETS, new entrants reserve (which investors could then sell on the market). The Council and Commission had offered 100-200 million. An agreement will likely come in the range of 300-350 million credits, which would allow for the financing of five to six pilot projects. In consideration, Parliament may agree to postpone emissions performance standards on CCS plant, which were opposed by some member states and the industry.
Biofuels
¶6. The French have also reached a compromise with the Parliament on biofuels targets. Biofuels are a component of the renewables directive, which establishes a 10% target for renewable energy sources for transport, including also

electricity and hydrogen fuel cells, by 2020. Under the agreement, biofuels must yield a 35% lifecycle greenhouse gas (GHG) emissions savings commencing in 2010. By 2017, biofuels from existing plants must yield a 50% savings, while new plants must produce fuel with a 60% savings. There are no mandatory social criteria applicable to producers, but firms will be required to report to the Commission on social conditions (i.e. labor) at production locations.
¶7. The legislation does not require calculations for indirect land use change (ILUC) at this time due to the lack of reliable scientific data. However, the Commission will commence a study on ILUC in 2010 in an effort to incorporate by 2012 ILUC calculations into the biofuels legislative targets. In order to spur investment in biofuels, producers who achieve a minimum of 45% GHG savings before 2013 will be excluded from ILUC calculations until 2017.
Renewables) Italy Still Holding Out
¶8. An agreement on the renewables target) 20% of energy production from renewable sources by 2020) has yet to be reached, with Italy as the lone holdout. About 8.5% of Europe,s energy production currently comes from renewable sources; 7%comes from hydroelectric sources and the remaining 1.5% is mainly from wind and solar. To bridge the 11.5% gap, targets will be apportioned among the member states based on their capacities to implement new technologies.
¶9. Italy, which one Commission official described as the member state best poised to benefit from wind and solar, claims that the costs to transform its energy industry would be prohibitive. It is seeking a renewables trading mechanism, along the lines of the ETS. Under this scheme, member states could invest in renewable technologies in other member states or import renewable energy from outside the EU, in Italy,s case from North Africa and/or Albania. While there is much support for this proposal, Italy does not want to hedge its bet. Thus, it insists on a review of the scheme in 2014, a proposal opposed by other member states and Parliament. Nonetheless, there is optimism that this will be resolved and the EU,s leaders will announce a political agreement by 11 or 12 December to coincide with the final day of talks at Poznan. Thereafter the package will be sent to the Parliament, which could approve it as early as December 15, giving the French Presidency its major deliverable in

time for the holidays.
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